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REAL ESTATE ECONOMISTS, APPRAISERS AND COUNSELORS

COMMENT ON THE LIBERALIZED HOUSING LEGISLATION OF 1953

WHEN Congress gave its nod of approval to new housing legislation for the coming year and President Eisenhower signed the bill on June 30, euphoria pervaded the housing industry. Home builders could hardly contain their exultation while congressional leaders saw the liberalized law as a boon to the real estate market and the national economy generally.

Senator Homer Capehart, chairman of the Senate Banking Committee that drafted the major part of the law, said that it would "dissipate the fears of all those who are omnisciently pointing to an impending depression." Representative Jesse P. Wolcott, chairman of the powerful House Banking Committee, declared the new law would allow builders to "build all the houses the economy will absorb."

In ratifying the "standby" relief program for home builders - permission for President Eisenhower to reduce down payments and extend mortgage terms - Congress granted the builders more than they asked for and far more than they expected. Leaders in the industry had suggested cutting down the payment required to 10 percent on $10,000 homes - not the 5 percent incorporated in the law.

Many builders figure they have largely taken care of the immediate postwar demand for houses in the higher price brackets and now must turn to the production of mass low-cost homes. They look upon the $12,000-and-under housing as the crucial field in the period ahead.

Screened from the bill before it received final approval was a provision to compel builders to give FHA and VA home purchasers a 1-year warranty against "jerry-built" construction.

Builders contended that unreliable and "Johnny-come-lately" operators who had been guilty of such unscrupulous practices had been driven out of business. Spokesmen for the builders were so convincing that Congress, evidently persuaded, took them at their word: dropped the warranty provision.

Also written into the new law is a clause prohibiting the regulation of discounts by VA and FHA. Only fees and charges may be regulated. This proviso virtually legalizes discounts on insured and guaranteed mortgages. Hence, we

now have for VA and FHA mortgage loans what in effect is a highly tractable yield or interest charge.

On May 18 Bert King, loan guaranty director for the VA, issued a ban on discounts and warehousing which compounded the nation's mortgage headaches. It was an administrative edict that brought a deluge of bitter complaints from builders all over the country. Builders and originating lenders protested violently that the VA ban on such discounts practically brought to a halt construction of homes for veterans. Some builders even went so far as to call it a retaliatory action by VA officials for having $4\frac{1}{2}$ percent interest forced on them. The recent action of Congress does away with all such rulings entirely.

In other words, the law allows builders to assume any losses incurred in marketing mortgages, but it expressly forbids their passing the cost of discounts on to the home buyer. The Veterans Administration is authorized to adopt "reasonable measures" to prevent discounts from being passed along to veterans. Congress made it plain that VA's certificates of reasonable value (CRV), which determine the ceiling price on each house, are the apparatus to do this.

Unlike the VA, the FHA places no limitation on selling price, but only limits the insurable amount of the mortgage by its valuation. However, FHA and VA regulations stipulate certification by the builder or any other seller that none of the discount is wrapped up in the sale price and by such means passed on to the mortgagor-purchaser. Brown L. Whatley, president of the Mortgage Bankers Association, advises: "Under the discount system the added interest charge which is required in excess of the fixed rate to obtain marketability for the mortgage is payable in a lump sum at the outset. This is no concern of the mortgagor-purchaser so long as he may be certain that all such excess interest or discount is paid out of the pocket of the builder or other seller and not out of his own."

Moreover, it appears to this observer that the unlimited discount operation should act as a powerful loadstone in attracting to mortgage financing a larger ratio of investment funds and in providing a better balanced distribution of such funds nationally. Furthermore, the decontrolled discounts make possible a wide diversity of yield regionally.

Thus, builders could construe the amendments and the fringe benefits as solving the only immediately solvable part of the industry's mortgage troubles.

The law restokes the Federal Housing Administration with authority to guarantee another $1.5 billion in home mortgages. This is distinct from the $500 million granted last March to the FHA's authority to insure home repairs and other improvements. It also unleashes an additional $200 million for support of the FNMA's VA and FHA mortgage buying program.

"Fanny May" already had $180 million on hand for this purpose.

As another tool for "smoking out" mortgage money the law provides the

FNMA with authority to operate a "one-for-one" sale and purchase program of the mortgages now held in its portfolio. The prior commitments to buy mortgages equal to amounts sold, however, must not exceed a ceiling of $500 million of the $2.5 billion that "Fanny May" holds. FNMA is further empowered to use an estimated $200 million remaining from the $900 million formerly reserved for purchases of defense and disaster housing mortgages for over-the-counter purchasing.

On August 24 the Federal Housing Administration announced liberalization of its insured mortgage plan to encourage builders to accept older houses in trade for newer dwellings. Guy Hollyday, FHA Commissioner, said the more liberal program will help builders refinance existing mortgages on them. Under the new FHA ruling a builder may get FHA insurance covering 80 percent of the first $7,000 of value and in addition 60 percent of the balance up to a total loan of $10,400. The FHA Commissioner declared the decision to liberalize the mortgage insurance plan in this manner was made as the result of practical experience gained in the field of trade-in houses.

The new one-for-one sale and purchase plan of FNMA has probably aroused more interest than any other of the changes in the housing law. "Fanny May" released the latter part of July its rules and regulations concerning the one-for-one program authorized by the Housing Amendments of 1953.

FNMA will now issue firm commitment contracts to originating mortgagees, valid for 1 year, binding FNMA to buy from them at par a stated amount (in dollars) of VA Section 501 $4\frac{1}{2}$'s and/or FHA Title II Section 203 $4\frac{1}{2}$'s.

Here's what it will cost to acquire FNMA commitments.

To start with, FNMA will charge a commitment fee of 1 percent, irrefundable under any and all conditions, and when mortgages are proffered for purchase, pursuant to the commitment contract, FNMA will levy an acquisition fee of one-half of 1 percent. Consequently, firm FNMA fees total $1\frac{1}{2}$ percent and in actual effect pare down the commitment price to $98\frac{1}{2}$.

Then to acquire commitment contracts the mortgagee must purchase from FNMA, or arrange for someone else to purchase, an equal amount of loans from the loans retained in FNMA's portfolio. While FNMA is offering to dispose of its loans at a discount, 98 for VA 4's and 97-3/4 for Title II Section 203 $4\frac{1}{2}$'s, even lower prices will surely be necessary in this market to get any action from long-term investors.

Hence, a mortgagee interested in obtaining commitment contracts must buy, or find a buyer for, the same amount of FNMA mortgages, and, in addition, he must absorb the loss between FNMA's upset selling price and the lower price at which the loans can be marketed for long-term investment.

Under existing market conditions it is not out of line to hazard the conjecture

that the added cost of FNMA commitment contracts will immediately cover a scope of 3 or perhaps 4 points.

During the initiatory period under the unlimited discount system it can be expected that when a builder or other seller certifies that none of the mortgage discount is included in the selling price, the certification may usually be depended upon. However, as time brings changes in the market it will quite likely call for more and more credulity to retain implicit confidence in these certificates.

The acrimonious and exaggerated complaints concerning the tightness of mortgage money are becoming so magnified and distorted that they hardly merit serious attention because of their unreasonableness. To refute the oft-repeated claim that there is an alarming shortage of mortgage financing funds one has only to turn to the mortgage recordings.

During the first 7 months of 1953, mortgage recordings of $20, 000 or less totaled $11, 393 million, or $1, 334 million above the $10, 059 million for the same 7 months of 1952. This was a gain of 13 percent. The most active area was the Chicago District with an increase of 21 percent, followed by the Boston and San Francisco Districts with 17. 5 percent gains. Other increases varied from 3 percent in the Greensboro area to 16 percent for the Indianapolis District. This hardly confirms the yelping over the tightness of mortgage money.

There is plenty of money available for sound mortgage loans where the terms asked for are reasonable and the interest charge brings an adequate return; and there always will be. However, the period in which a mortgage lender can operate with practically no worry or undue hazard is past.

The unlimited discounts for VA and FHA mortgages are not to my liking. The mortgage discount system is a cumbersome apparatus with an abundance of risks attached to its administration by reason of the possible abuses of the unlimited discounts. There are also dangers involved in the discount operation which might threaten the integrity of the FHA in the eyes of the public.

I am not in favor of unlimited discounts as a means for implementing a higher mortgage yield. An authorized interest rate of 5 percent would have been a simpler and more effective step to meet the need for a better competitive yield in today's market. (Congress has given authority to FHA to adjust the interest rate to a maximum of 5 percent.)

I consider it most unfortunate that the new housing amendments permit 30-year mortgages with as little as a 5 percent down payment when we are supposed to be still trying to hold the line against inflation. The new housing legislation convinced me that Republican "hard money" Congressmen would have no compunction in switching policies to any degree to ward off deflation.

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